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In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 129

JOHN FREULER, ADMINISTRATOR OF THE ESTATE OF Louise P. V. Whitcomb, petitioner

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 42) is reported in 22 B.T.A. 118. The opinion of the Circuit Court of Appeals (R. 154) is reported in 62 F. (2d) 733.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 9, 1933 (R. 161). The time within which a petition for certiorari might be filed was extended by a Justice of this Court to June 8, 1933. The petition for writs of certiorari was filed June 6, 1933. Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The petitioner is administrator of the Estate of Louise P. V. Whitcomb, who died in 1921. The Commissioner of Internal Revenue asserted against him, as her administrator, a deficiency on account of federal tax on her income for the year 1921. This case involves the question whether the amount on account of which the deficiency was asserted was income taxable to her under Section 219 of the Revenue Act of 1921. The amount in question was actually paid in that year by the trustee of a testamentary trust to her, a beneficiary of the trust, as part of her share of the income of the trust. Thereafter the state court having jurisdiction over the accounts of the trustee held that the amount in question should not have been paid to her, but should have been retained by the trustee as a reserve for depreciation of certain property which produced the revenue. The state court decreed that the petitioner repay the amount in question.

(The situation is, of course, the same as if the decedent had lived: no question arises out of the fact that an administrator is involved.)

For a more detailed statement of the facts, see pp. 3-6, *infra*.

STATUTES INVOLVED

The statute involved is Section 219 of the Revenue Act of 1921, c. 136, 42 Stat. 227, 247. This section is copied on pages 39-43 of the appendix. Provisions of earlier and later Revenue Acts re-

lating to the same subject are also printed in the appendix, pages 43-49. The most important provision of the 1921 Act is that

> there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, *is distributable to such beneficiary, whether distributed or not.*[1]

STATEMENT

The following is a summary of the important findings of the Board (R. 34-42), amplified by occasional references to uncontradicted evidence.[2]

A. C. Whitcomb died in 1889, a resident of California. His will, probated in the Superior Court of that state, left the residue of his estate in trust, to pay his widow one-third "of the interest thereon or income therefrom" for her life and the other two-thirds of the income to the testator's children, Adolph and Charlotte, "with the reversion or remainder of the whole three-thirds parts to the descendants 'per stirpes' of the said two children, if any be alive at the time of the death of the said two children; and if none be alive at that time, to Harvard College."

The widow died in 1921, and during 1921 part of

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[1] Throughout this brief, the italics are ours.

[2] Where any evidence is referred to which is not embodied in the findings of the Board, reference is made to the pages of the record on which the evidence appears.

the income was paid to her and part to the petitioner, her administrator.

The residue which passed under the trust originally consisted very largely of cash, bonds, stocks and notes. In 1906 these items had a total value of more than $3,000,000. The trust estate also included certain parcels of real estate, mostly in San Francisco. On April 18, 1906, the San Francisco earthquake and fire destroyed all of the improvements on the San Francisco real estate. Some time after that fire, the trustee adopted the policy of improving the real estate owned by the trust and of converting other assets of the estate to accomplish the purpose. As a result of this policy and of the acquisition of additional parcels of real estate, the assets of the trust estate during 1921 (as well as several years prior thereto and subsequent thereto) consisted almost entirely of improved real estate, including the Whitcomb Hotel and its furniture and equipment, this one building and its contents representing an investment of more than $2,000,000.

During the taxable year here involved, these assets of the trust estate suffered exhaustion, wear and tear. The exact amount of depreciation for each year was specifically found by the Board. During 1921 alone it was slightly in excess of $43,000.

The trustee, however, did not withhold from the beneficiaries to whom payments of income were

being made anything on account of this depreciation. The will contained no express directions in regard to the manner in which the income from the trust should be computed, accounts kept, or depreciation provided for.

The trustee's account covering the period from February 23, 1903, to February 23, 1928, was filed in the Superior Court of California with a petition for its allowance in 1928. Two of the remaindermen, grandchildren of the testator and children of Charlotte, (who evidently were minors during a large part of the period involved but had then attained their majority)[1] filed certain objections to the account. After notice and a hearing, in which all of the parties in interest, including the petitioner, were represented by counsel, the court disallowed certain of the objections (R. 143-144), but allowed the objection that no reserve or other provision for depreciation for the years 1913 to 1927 had been made, and entered a decree which, as amended, provided that the beneficiaries who had received income should repay to the trust estate an amount in excess of $622,000. on account of depreciation sustained during the years 1913 to 1927 and

[1]The ages of the children of Charlotte do not definitely appear in the record. From the will, however, it does appear that Charlotte was born in 1882 (R. 35). Consequently it seems highly improbable that any child of her could have attained the age of twenty-one until after 1920. That her children who opposed the account were of age in 1928 appears from the fact that an attorney appeared for them and not, as in the case of certain other beneficiaries, for their guardians (R. 129-132, 140-141).

that thereafter until termination of the trust the trustee should withhold annually as a reserve for depreciation a reasonable and proper amount from the income of the trust property.

The petitioner repaid $10,700. in cash.

The trustee, in his fiduciary return for the year 1921 (as well as other years), in computing the net income of the trust, deducted the amount of depreciation sustained by the trust estate; and neither the petitioner nor any other beneficiary included in his or her return of income for these years (or the other years) the amount paid by the trustee representing his or her share of the amount deducted on the fiduciary return for depreciation.

The Commissioner of Internal Revenue increased the income shown on the petitioner's returns for 1921 by his proportionate share of the amount allocated to depreciation, and on that basis asserted deficiencies in the tax of the petitioner for that year.

A majority of the Board of Tax Appeals held that the petitioner was correct in contending that he was not taxable upon the amounts representing depreciation which his intestate received and which he had been ordered to return, and entered an order of redetermination for only certain very small sums, which the petitioner did not contest in the court below and which are not involved here. (R. 54.)

The Commissioner filed a petition for review by

the Circuit Court of Appeals, contending in effect that the Board erred in holding that the distributions made by the trustee to the petitioner's intestate "were not taxable income to her in their entirety." (R. 58.)

That court sustained the contention of the Commissioner, holding that by Section 219 Congress "intended to tax each year to the beneficiary of any trust the share of the trust income which *was distributed* to him in that year," in spite of the fact that what the statute provided the beneficiary should include in his return was "that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is *distributable* to such beneficiary, *whether distributed or not.*" The court also held that the order of the state court was not conclusive upon it in considering a revenue act, and said that the loss due to depreciation "is borne by remaindermen in determining the tax." (R. 158-159.)

SPECIFICATION OF ERRORS

The Circuit Court of Appeals erred:

(1) In holding that the taxpayer is taxable upon the amounts received by him and his decedent from the trustee which were not properly distributable to them.

(2) In holding that the order of the state court was not conclusive on the question as to what amounts were properly distributable to the beneficiaries of the trust.

(3) In holding that the trustee was not obliged to withhold from distribution a reasonable allowance for depreciation of the improvements and hotel furniture.

(4) In reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

I.

This case concerns the taxability of certain money paid as income to a beneficiary of a trust of which the income was to be distributed to the beneficiaries periodically.

Section 219 of the Revenue Act of 1921 imposes a tax, *inter alia,* upon "income received by estates of deceased persons during the period of administration or settlement of the estate" and "income which is to be distributed to the beneficiaries periodically." Executors, in determining the net income of estates during the period of administration are allowed to deduct "the amount of any income properly paid or credited to any legatee, heir or other beneficiary." Subdivision (d) of this section also contains the following provision, which is applicable to both classes of income above mentioned:

> The tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order

governing the distribution, is distributable to such beneficiary, whether distributed or not.

The language above quoted, as well as other parts of this section, indicates clearly that the test of taxability to beneficiaries of income of both of the sorts mentioned is not actual receipt of money by them, but their legal right to receive the money. They are taxable only as to income to which they are lawfully entitled.

Section 219 of the previous Act—that of 1918—contained similar language. The Regulations which were in force under the 1918 Act at the time when the 1921 Act was passed provided that each such beneficiary (whether the beneficiary of a trust in which there was income distributable periodically or a legatee of an estate before final settlement to whom income was properly paid) should include in his return "his distributive share of the net income even though not yet paid him, but if the taxable year on the basis of which he makes his returns fails to coincide with the annual accounting period of the estate or trust, then he need only include in his return his distributive share for such accounting period ending within his taxable year." The language of the Regulations thus indicated clearly (as indeed the language of the 1918 Act required) that the test of taxability of income was the same for legatees receiving income in the course of the settlement of an estate and for beneficiaries of a trust, the income of which was to be distributed

regularly. With this construction in force, Congress passed Section 219 of the 1921 Act, which shows that it approved this construction of the Department. Regulations issued under the 1921 Act were, as to this matter, practically identical with the Regulations under the 1918 Act.

In many cases arising under Sections 219 of the various Acts, the Commissioner and the courts apparently took the view that in order to impose a tax on income received by a beneficiary it was necessary to show that he was lawfully entitled to the money.

As far as we are able to ascertain, it was not until the instant case and its companion cases were argued that the Commissioner advanced the contention that the statute should be construed to tax a beneficiary of a trust on money paid to him through a mistake of law.

Apparently the only statement of any court which is contrary to our contention is that of the court below in the instant case. The Court of Appeals of the District of Columbia in the companion cases (in which this Court has also granted certiorari) did not so decide. The dissenting opinion of Groner, J., in that court expressly adopted our contention, and the majority opinion contained nothing to the contrary. (R. 63.)

Furthermore, the 1921 statute, as we construe it, requires that, of the income of a trust like this,

the beneficiary is to return that part which is distributable to the beneficiary *"pursuant to the order governing the distribution,"* if there is such an order.

II.

The California Superior Court, having jurisdiction over the trust estate, after hearing the parties, entered an order that the petitioner was not entitled to the amount in question and ordered him to repay it. This decision is controlling.

For if, as we contend, Section 219 should be construed as making the test of taxability whether the amounts received by a beneficiary were distributable to such beneficiary pursuant to the *order* governing the distribution, the order of the California court which had jurisdiction over the trust estate and the parties was just such an order as the statute envisages.

And even if the word "order" in the statute has no application, it is nevertheless true that the state court has settled the property rights of the petitioner as to the amount in question and no decision of any other court can enlarge them.

Under the proper construction of the statute, the only question is what income was distributable, or in other words, what property rights the taxpayer had. That right depends upon and is regulated by the state law, and as this Court said in *Uterhart* v. *United States,* 240 U. S. 598, 603: "It

is obvious that a judicial construction of the will by a state court of competent jurisdiction determines not only legally but practically the extent and character of the interest taken by the legatees." Although it is true that the federal courts are not bound in all cases to follow the construction of a will adoped by a state court, they cannot disregard the decision of the state court under which property rights have been settled, where, as here, the question is simply what the property rights are. *Farwell* v. *Commissioner,* 38 F. (2d) 791, 795 (C. C.A. 2d); *Commissioner* v. *Field,* 42 F. (2d) 820, 822 (C.C.A. 2d); *McCaughn* v. *Girard Trust Company,* 19 F. (2d) 218 (C.C.A. 3d); *Pitman* v. *Commissioner,* 64 F. (2d) 740 (C.C.A. 10th). See also *Keith* v. *Johnson,* 271 U. S. 1.

The holding of the court below flies in the teeth of Revised Statutes, Section 905, which provides that the records and proceedings of state courts if properly authenticated "shall have such faith and credit given to them in every court within the United States as they have by law or usage in the courts of state from which they are taken."

The argument of the Commissioner that the decision of the state court should be disregarded because it was not made until long after the end of the taxable year here involved is untenable. *McCaughn* v. *Girard Trust Company,* 19 F. (2d) 218, (C.C.A. 3rd).

III.

In any event, apart from the question whether the decision of the state court was conclusive, it is clear that under the state law and on general principles the trustee was obliged to withhold from distribution a reasonable allowance for depreciation of the improvements and hotel furniture. The decision of the Superior Court of California was required by the holding of the highest court of that state in *In re Gartenlaub,* 185 Cal. 648. There is no statute or decision of any California court in conflict with the decision of the Superior Court, and it is in accord with the holdings of the courts in various other states.

ARGUMENT

I.

THE PETITIONER WAS TAXABLE ONLY UPON SO MUCH OF THE AMOUNT PAID BY THE TRUSTEE AS WAS PROPERLY DISTRIBUTABLE

The court below decided against the petitioner on this point. But the Court of Appeals of the District of Columbia in the companion cases did not so decide. Judge Groner, in his dissenting opinion in that court, expressly agreed with our contention, and the majority opinion contained nothing to the contrary. (R. 173.)

The taxability of the amount in question is governed by those provisions of Section 219 of the Revenue Act of 1921 which govern income of trusts which is to be distributed to the beneficiaries periodically. That section, which is the sole section under the part of that act headed "ESTATES AND TRUSTS," lays down comprehensive formulae for determining what income of estates and trusts is to be included in the net income of fiduciaries and what is to be included in the net income of individuals subject to the normal tax and the surtax which are imposed by Sections 210 and 211. Section 219 of the 1921 Act provides in part as follows:[4]

> (a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or

[4] The entire section, except subdivision (f), is printed in the appendix, pp. 39-43.

of any kind of property held in trust, including—

(1) Income received by estates of deceased persons during the period of administration or settlement of the estate;

* * * * *

(4) *Income which is to be distributed* to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

* * * * *

Subdivision (b) of this section provides that the fiduciary shall make returns of the income and that

> . . . In cases in which there is any income of the class described in paragraph (4) of subdivision (a) of this section the fiduciary shall include in the return a statement of the *income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable to each beneficiary, whether or not distributed* before the close of the taxable year for which the return is made.

Subdivision (c) provides in part that—

> . . . in determining the net income of the estate of any deceased person during the period of administration . . . there may be deducted the amount of any income *properly paid* or credited to any legatee, heir, or other beneficiary.

Subdivision (d) contains the following provision:

> In cases under paragraph (4) of subdivision

(a), and in the case of any income of an estate during the period of administration or settlement permitted by subdivision (c) to be deducted from the net income upon which tax is to be paid by the fiduciary, the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary *that part of the income of the estate or trust for its taxable year which pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not,* . . .

Subdivision (e), which applies to cases in which an estate or trust includes both income of the class described in subdivision (a) (4) and other income, contains similar provisions.

In the above, the phrases italicized are manifestly synonymous. They all refer to what ought to be done, rather than to what has been done.

Subdivision (a) (4) is concerned not with the income distributed periodically but that "which *is to be* distributed . . . periodically." Subdivisions (b), (d) and (e) deal not with what is distributed, but with what is "*distributable . . . whether or not distributed.*" Obviously the provisions concerning the income of trusts which is to be distributed to the beneficiaries periodically—in subdivisions (a), (b), (d) and (e)—are based on the same policy as that of subdivision (c) regarding decedents' estates. Indeed, subdivision (d) relates both to beneficiaries of trusts and to legatees of estates,

and that part of its language which is italicized above must have the same meaning for both of these classes of taxpayers. In the case of legatees receiving income from an estate during period of administration, it must mean they are taxable only upon income *properly* paid or credited, as it is only such income which the fiduciary is entitled to deduct in computing net income of the estate which the fiduciary is to pay. Hence, even if there were any doubt as to the meaning of the words which apply solely to beneficiaries of trusts, it would have to be resolved to harmonize with the language of subdivision (c).

The underlying theory is that taxes on income covered by Section 219 are to be determined not by the physical facts concerning the payment of the money, which might be affected by mistakes of the parties, either as to law or fact, or by the desire of the parties so to adjust these matters as to escape income tax, but by the legal rights and duties of the parties. Nowhere is there any indication that consideration is to be given to the actual receipt of money by a beneficiary. The test adopted is the antithesis of this—whether the income is *distributable*. Had Congress intended to include all sums actually distributed as well as those properly distributable (as the Commissioner argued in the court below), it could easily have expressed that idea, and its failure to do so, as well as the use of the expressions italicized above, manifests clearly

the intention to tax the beneficiaries only upon those amounts to which they are rightfully entitled.

It is, of course, well established that the language of a tax statute is not to be extended beyond its clear import, and in case of doubt is to be construed in favor of, rather than against, the taxpayer. *Crooks* v. *Harrelson*, 282 U. S. 55, 61; *United States* v. *Merriam*, 263 U. S. 179, 187-188; *Gould* v. *Gould*, 245 U. S. 151, 153.

Our construction of Section 219 is that which appears always to have been adopted by the regulations of the Treasury Department, and Congress has in various Acts repeated enough of the language of the statute here involved to evidence its approval of this construction.

Section 219 of the Revenue Act of 1918 was similar to Section 219 of the 1921 Act, although not quite so explicit. The provisions from subdivisions (a), (b) and (c) of the 1921 Act quoted above appeared in substantially the same form in the 1918 Act. In the 1918 Act, subdivision (d) of this section provided:

> . . . there shall be included in computing the net income of each beneficiary *his distributive share*, whether distributed or not, of the net income of the estate or trust for the taxable year.

In later Revenue Acts, Congress used similar language. See Section 219 of the Act of 1924, Sec-

tion 219 of the Act of 1926 and also Sections 161-164 of the Act of 1928.[5] All of these also contain substantially the same language as that from Section 219 (c) of the 1921 Act which is quoted above.

Article 345 of Regulations 45, promulgated under the Revenue Act of 1918 on January 28, 1921, provided:

> In the case of (a) a trust the income of which is *distributable* periodically . . . and (c) an estate of a decedent before final settlement as to any income *properly* paid or credited as such to a beneficiary, the income is taxable directly to the beneficiary or beneficiaries. Each such beneficiary must include in his return *his distributive share* of the net income, even though not yet paid him, but if the taxable year on the basis of which he makes his returns fails to coincide with the annual accounting period of the estate or trust, then he need only include in his return his distributive share for such accounting period ending within his taxable year.

Substantially the same language is found in Article 345 of Regulations 62, promulgated under the Revenue Act of 1921 on February 15, 1922. As far as we are able to ascertain, these provisions of these two sets of regulations have never been modified.

Moreover, in Law Opinion No. 1013, promulgated in 1920 (2 C.B. 181, 183), the Solicitor of Internal Revenue, discussing Section 219 of the Act of 1918 relating to the income from trusts, said:

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[5]These are copied in the appendix, pp. 43-48, *infra*.

> it would be highly inequitable and unjust to tax the present beneficiary upon income which is not distributable to him and to which he is not beneficially entitled.

It is, of course, well settled that great weight will be attached to the long adopted construction of tax statutes by the Department of the Treasury. This Court has said that a construction "ought not to be disturbed now unless it be plainly wrong." *Universal Battery Co.* v. *United States,* 281 U.S. 580, 582. And where, as here, Congress in subsequent acts has reenacted substantially the same language, that operates as legislative approval of the construction adopted by the Treasury Department. *Brewster* v. *Gage,* 280 U.S. 327, 336; *McCaughn* v. *Hershey Chocolate Co.,* 283 U.S. 488, 492-493.

As far as we can ascertain, never until the instant case and its companion cases were argued did the Commissioner contend that Section 219 of the 1921 Act or any or the similar provisions of other Acts should be construed as imposing a tax on money improperly distributed.

The Court of Appeals of the District of Columbia in a case involving the tax of another beneficiary under the Whitcomb trust for a previous year under a similar statute, section 219 of the Revenue Act of 1918, *Whitcomb* v. *Blair,* 58 App. D.C. 104, apparently proceeded upon the construction for which we contend. Although that court decided against the taxpayer in that case, its conclusion was

based upon the assumption (then agreed to by both parties) that the taxpayer was entitled to all of the sums which she had received. Thus, that court there said that "the payment made by the trustee to appellant was in fact and law the distributive share of the income *to which she was entitled* as life tenant."

There was no suggestion made in behalf of the Commissioner in *Whitcomb* v. *Blair, supra,* that the amount in question was taxable to the taxpayer merely because she had received it. The Commissioner then evidently felt that his case must be founded upon the proposition that she was rightfully entitled to it, and a considerable part of his brief was directed to the argument of this proposition and to a demonstration that the taxpayer there did not contest that proposition.[6]

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[6]Thus, in his answer filed with the Board of Tax Appeals in that case, he asserted:

> "(1) Under the Revenue Act of 1918 the beneficiary of a trust is required to include in his return and is taxable upon the entire amount of the income of such trust which under the terms of the trust and the laws of the state governing the same is *distributable to such beneficiary* during the taxable year" (R. 16).

Point III of his brief in that case was headed:

> "The 'distributive share' of the appellant in the income of the frust estate, within the meaning of the statute, was the income actually *distributable* to the appellant under the provisions of the will" (p. 13).

His brief asserted that the section there involved:

> "provided in express terms that the income which should be

As far as we can ascertain, there is no authority outside of the decision of the court below supporting its construction of Section 219 of the Revenue Act.

In *Burnet* v. *Whitcomb,* 65 F. (2d) 803 (R.163), a majority of the Court of Appeals of the District of Columbia upheld the Commissioner's determination of deficiencies against another beneficiary under the trust here involved. The majority did not definitely pass upon the question of the construction of the statute, but Judge Groner, in his dissenting opinion, said:

> Fairly construed, I think it cannot be doubted that the true test of liability depends upon whether the income is distributable. If it is, it is taxable whether received or not. If it is not, it would seem to me to follow that it is nontaxable, even though received, as, for instance, by mistake.

The opinion of the majority of the Court of Appeals of the District of Columbia relied upon a number of other cases which justify an inference contrary to the ruling of the Circuit Court of Ap-

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taxable to the beneficiary of a trust should be *the portion of the income of the trust 'which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary.'* The language of this section is so explicit that there can be no doubt that the taxable income of the beneficiary is the portion of the income of the trust *actually distributable to him*" (p. 23).

In his brief, he also contended:

"What is taxed . . . is the income *distributable* to the appellant under the will" (p. 26).

peals in the instant case on this point. Among these cases are: *Hubbell* v. *Burnet,* 46 F. (2d) 446 (C.C.A. 8th) certiorari denied 283 U.S. 840; *Baltzell* v. *Mitchell,* 3 F. (2d) 428 (C.C.A. 1st) certiorari denied 268 U.S. 690. See also *Roxburghe* v. *Burnet,* 58 F. (2d) 693 (App. D. C.). Those cases, either finding or assuming that certain income was distributable, held that it was taxable to the beneficiary. They certainly sustain Judge Groner's conclusion from them that, "If it is, it is taxable whether received or not." They also seem to compel his final conclusion that, in the converse case, "If it is not . . . it is nontaxable, even though received, as for instance, by mistake."

See also *McCaughn* v. *Girard Trust Company,* 19 F. (2d) 218 (C.C.A. 3rd).

The construction adopted by the court below enforces double taxation in cases like the instant case, thus violating the fundamental principle of our tax system. In the instant case the trustee distributed more than was distributable. According to the rule laid down by the court below, the trustee in such cases is taxable upon the net income, less the amount *distributable,* while the beneficiary is taxed upon the amount *distributed.* The excess of the distribution over the amount distributable is taxed twice, once in the hands of the trustee, who is only allowed to deduct what is *distributable,* and again in the hands of the beneficiary, who is taxed

upon everything *distributed.* Similarly if, owing to a mistake, the trustee paid income to the wrong person, that person would be taxed upon it, as well as the beneficiary who was entitled to it. This is contrary to what has been the uniform ruling under our income tax laws that when income was taxable to the trustee, the beneficiary later receiving the income paid no tax (T. D. 1906; Regulations 33, Article 75, T. D. 1944; Regulations 33, Article 29, revised January 2, 1918).

Such a rule is contrary to numerous decisions of the Board of Tax Appeals, in some of which the Commissioner has acquiesced.[7]

That this was not the intention of Congress is demonstrated by the fact that the Act contains no provision allowing a beneficiary of a trust any deduction for any amount which he receives wrongfully and repays. As none of the provisions for deductions is broad enough to apply to such a situation, it must have been contemplated that the test was not actual receipt of income from the trust, but the right to receive it.

In the court below in the companion case, the Commissioner argued:

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[7] *Pyle v. Commissioner,* 16 B. T. A. 218; *White v. Commissioner,* 25 B. T. A. 243; *McCrory v. Commissioner,* 25 B. T. A. 994; *Dixon v. Commissioner,* 25 B. T. A. 1164; *Newbury v. Commissioner,* 26 B. T. A. 101, acquiescence by Commissioner XI I. R. B. No. 32, p. 1; *Boston Safe Deposit and Trust Company v. Commissioner,* 26 B. T. A. 486; *Yukon Alaska Trust v. Commissioner,* 26 B. T. A. 635, acquiescence by Commissioner XI I. R. B. No. 39, p. 1.

> However, even if the beneficiaries restored the amounts in question, they would only be entitled to a deduction in the year of restoration and not during earlier years.

It is significant, however, that in the only case directly involving this point which we have been able to find, the Commissioner argued that no deduction could be made in the later year, and the Board of Tax Appeals so held. *Pyle* v. *Commissioner,* 16 B.T.A. 218. We believe that that decision was correct. The repayment of income from a trust received by mistake is certainly not within the category of "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business" which Sec. 214 (a) (1) of the 1921 Act and similar provisions of other Revenue Acts allow as a deduction.

None of the cases cited by the Commissioner in the courts below in support of his contention that the mere receipt of income by a beneficiary is sufficient to render it taxable, such as *North American Oil Consolidated* v. *Burnet,* 286 U.S. 417, involved Section 219 of the statute or any section having similar language, or throw any light upon the construction to be given to Section 219. In the *North American Consolidated* case, the Court pointed out that under the provisions of the sections there involved the taxpayer would be allowed a deduction for amounts repaid in a later year, a situation

which, as we have just pointed out, does not exist here.

Furthermore, the 1921 statute, as we construe it, requires that, of the income of a trust like this, the beneficiary is to return that part which is distributable to the beneficiary "*pursuant to the order governing the distribution,*" if there is such an order.

The order and decree of the California court settling the trustee's account (R. 39-41) was such an order. Under Section 1120 of the Probate Code of California:

> When a trust created by a will continues after distribution, the superior court shall not lose jurisdiction of the estate by final distribution, but shall retain jurisdiction.

This section contains elaborate provisions for an accounting by the trustee, such as was made in the instant case. Such a trustee acts constantly under the direction of the court. Whatever he does is tentative until his accounts are settled. In California, therefore, we have an instance of "the juridical conception that a testamentary trusteeship . . . is due to the court authenticating the will." (*In Re Ripley*, 167 N.Y.S. 162, 166.) To such a trustee we find those provisions of the Revenue Act of 1921 peculiarly applicable where they speak of an "order governing the distribution" of

income (subsection (b), subsection (d), subsection (e)).

But, even if the provision of the 1921 Act as to court orders is not applicable, nevertheless the amount received was not taxable unless it was rightfully *distributable,* and, as we point out below, this question is to be determined by the court having jurisdiction over the trust estate and not by any other court.

II.

THE ORDER OF THE STATE COURT HAVING JURISDICTION OVER THE TRUST ESTATE AND THE PARTIES DECREED THAT THE BENEFICIARY OF THE TRUST WAS NOT ENTITLED TO THE AMOUNTS IN QUESTION, AND THAT DECISION IS CONTROLLING HERE.

It should be borne in mind that the petitioner is not relying upon the decision of a court in the case of some other person. The decree of the Superior Court of California actually foreclosed the right of this petitioner to the very amount in question, and no decree of any other court in any other proceeding can now enlarge his rights as to that matter.

If, as we contend, the question is merely whether the income was distributable to the beneficiary *pursuant to the order governing the distribution,* there can be no question that the order of the Superior Court of California is conclusive. And

even apart from that provision, since present record shows that the question as to what was distributable to the beneficiary *pursuant to the instrument governing the distribution* has been decided by that court, that question is no longer open.

As this Court said in the recent case of *Burnet* v. *Harmel,* 287 U.S. 103, 110:

> The state law creates legal interests but the federal statute determines when and how they shall be taxed.

If, as we contend, the federal statute here involved taxes only income which was properly distributable, it is apparent that it is the state law which must determine what income was rightfully distributed. In applying the federal tax we must consider what substantive rights and obligations have arisen under the local law. Although so far as the federal government is concerned, proceedings between citizens in state courts are *res inter alios acta* and not binding upon the Federal Government by the doctrine of *res judicata,* nevertheless those judgments do give rise to rights and obligations upon which the Federal income tax depends. The income tax cannot be computed without giving effect to these judgments. As to this petitioner, the will must have the effect which the state court having jurisdiction has decided that it has. In view of its decision, the situation as to him is exactly the same as if the will had expressly provided that the trustee should withhold from distribution annually

amounts adequate to set up a reserve for depreciation. We submit that this proposition is established by this Court and that no decision of this Court conflicts with it.

Thus, in *Uterhart* v. *United States,* 240 U.S. 598, which involved the right to a refund of a federal succession tax, the Court, in order to determine the nature of the taxpayer's interest in the property, looked solely at the provisions of a decree of a state court; and said (p. 603):

> It is very properly admitted by the Government that the New York decree is in this proceeding binding with respect to the meaning and effect of the will. The right to succeed to the property of the decedent depends upon and is regulated by state law (*Knowlton* v. *Moore,* 178 U.S. 41, 57), and it is obvious that a judicial construction of the will by a state court of competent jurisdiction determines not only legally but practically the extent and character of the interests taken by the legatees.

In *Keith* v. *Johnson,* 271 U.S. 1, a case involving federal income tax, this Court reversed its previous ruling as to whether the New York transfer tax was primarily payable out of the estate, and held that it was bound to follow a later decision of the state court on the question. See also *United States* v. *Kombst,* 286 U.S. 424, 426; *Michigan* v. *Michigan Trust Co.,* 286 U.S. 334, 342; *Roberts* v. *Lewis,* 153 U.S. 367. *Cf. Trainor Co.* v. *Aetna Casualty & Surety Co.,* No. 13, October Term, 1933 (decided

November 6, 1933); *Burgess* v. *Seligman,* 107 U.S. 20, 33-34.

Although there are decisions of this Court which hold that the federal courts are not bound in all cases to follow the construction of a will adopted by the state court, we believe that no such case deals with any federal statute, or involves a situation similar to that here involved, where the state court, for example, "had the settlement of this estate in its grasp and sole jurisdiction." See *McCaughn* v. *Girard,* 19 F. (2d) 218, 219.

Most of the decisions in the lower federal courts support our view. See, for example, *Commissioner* v. *Field,* 42 F. (2d) 820 (C. C. A. 2d); *Farwell* v. *Commissioner,* 38 F. (2d) 791, 795 (C. C. A. 2d); *McCaughn* v. *Girard Trust Co.,* 19 F. (2d) 218 (C. C. A. 3d); *Pitman* v. *Commissioner,* 64 F. (2d) 740 (C. C. A. 10th).

In *Commissioner* v. *Field, supra,* a case involving federal income tax on income received from a trust estate, Learned Hand, J., said:

> Hence the case turns upon whether, after the Illinois decree, Marshall had a present interest in the income of Henry's share assignable under the law of Illinois.
>
> * * * * *
>
> Under the trustees' contention Henry's share after his death was still subject to the provisions for accumulation, the restraints on alienation and the contingent remainders over. *We need not consider the validity of these for*

> *we must accept the decree* as holding that Henry's share was not so limited after his death.

And in *Farwell* v. *Commissioner, supra,* a federal estate tax case, the court said:

> Because the probate court ratified and approved every payment made by the guardian and no application for re-examination and correction was made within two years, or appeal taken, the decision of that court is final and conclusive. General Laws of Vermont, § 3712. Although the probate court is of limited jurisdiction, its acts, orders, and decrees, within the scope of its jurisdiction are as conclusive as those of any other court. *Sparhawk* v. *Buell's Administrator,* 9 Vt. 41; *Tryon's Administrators* v. *Tryon,* 16 Vt. 313. And the probate court has exclusive jurisdiction of the settlement of accounts of guardians.

Where, as in our case, the state court has exclusive jurisdiction of the settlement of accounts of trustees, its decision must, by like reasoning, be final and conclusive, whether the federal tax involved is an estate or an income tax.

The argument of the Commissioner and the holding of the court below fly in the teeth of Revised Statutes, Sec. 905, which provides that the records and proceedings of state court if properly authenticated

> shall have such faith and credit given to them in every court within the United States as they

> have by law or usage in the courts of the state from which they are taken.

See, in this connection, *Bradford Elec. Co.* v. *Clapper,* 286 U.S. 145, 155; *Hartford Life Insurance Co.* v. *Barber,* 245 U.S. 146; *Tilt* v. *Kelsey,* 207 U. S. 43; *Mitchell* v. *First National Bank,* 180 U.S. 471.

At the time when the Revenue Act of 1921 was passed (it was approved on November 23, 1921), the Commissioner took the position that the decision of local courts as to the distribution of income should control. Law Opinion of the Solicitor of Internal Revenue, No. 1013, promulgated in 1920 (2 C.B. 181, 183), discussing Section 219 of the Act of 1918, relating to the income from trusts, stated that the federal statutes and not the rule of the probate court must govern the question as to what constitutes income, but went on to say:

> The decisions of the local courts, however, as to the distribution of such items of income are important. *They determine by whom the income should be accounted for.*

We submit that the statement from the Solicitor's opinion, quoted above, is correct. Anyway it expressed the attitude of the Department when the Revenue Act of 1921 was passed, and the Act of 1921 contains no language indicating that Congress intended to adopt the contrary rule, which the Commissioner seeks to apply in the instant case. Con-

sequently Congress must be deemed to have approved this construction. (See authorities cited on p. 20, *supra*.)

The respondent in his brief in opposition to the petition for certiorari in this case sought to distinguish certain cases on the ground that in them the decree of the state court in question was entered before the tax year involved. We submit that his position is unsound.

In *McCaughn* v. *Girard Trust Company*, 19 F. (2d), 218 (C. C. A. 3d), *supra*, the court held that a decree of a state court was binding on the Government in a federal income tax case, although it was entered by consent long after the taxable year.

See also *Keith* v. *Johnson*, 271 U.S. 1, 8, *supra*; *Messinger* v. *Anderson*, 225 U.S. 436; *Farwell* v. *Commissioner*, 38 F. (2d) 791 (C. C. A. 2d), *supra*; *Appeal of Appell*, 10 B. T. A. 1225, 1231.

The situation is similar to that which was presented in cases in which the Circuit Court of Appeals for the First and Second Circuits had both held that a certain instrument was invalid as a testamentary disposition. Subsequently a state court in Rhode Island, which had jurisdiction over its probate, decided that it was valid as a testamentary disposition. In subsequent proceedings both of these Circuit Courts of Appeals reversed their previous decisions, holding that they were bound by the decision of the Rhode Island court.

Atwood v. *Rhode Island Hospital Trust Company,* 34 F. (2d) 18, 22 (C.C.A. 1st); *Boal* v. *Metropolitan Museum of Art,* 19 F. (2d) 454, 459 (C.C.A. 2d). In both of these cases, petitions for certiorari were denied by this Court, 280 U. S. 600; 275 U. S. 565.

From what we have said, it must be clear that the order of the state court simply declared what the rights which previously existed were. Would the Commissioner contend that he should not, and the courts should not, pay any attention to any state decision as to the taxpayer's rights merely because it is rendered after the end of the tax year involved or after the filing of the return? Or if not, when would he regard a decision as too late to be noticed? In many trusts the trustees do not file their accounts annually, and it will often happen that matters relating to rights upon which a tax depends will not be decided until after the end of the taxable year and after the return is filed. Of course, it may happen that the taxes are finally settled before any adjudication is made, and in such event the taxpayer may have lost his rights to refer to the applicable decision of the state court. But where, as here, the decision of the state court is in evidence, it is immaterial when that decision was made.

III.

THE DECISION OF THE CALIFORNIA COURT THAT THE TRUSTEE SHOULD HAVE MAINTAINED A RESERVE FOR DEPRECIATION WAS CORRECT.

If, as we contend, the decision of that court is controlling, regardless of its correctness, it is unnecessary for this Court to decide whether it was correct or not. But even if the decision of the court below as to the binding force of the decree should be upheld, we nevertheless insist that its judgment should be reversed on the ground that the decision of the California court was correct.

The opinion of the court below did not discuss this matter at all.

The decision of the Superior Court was required by the holding of the highest court of that state in *In re Gartenlaub,* 185 Cal. 648. In that case the trustee had purchased bonds at a premium. The court said (page 652):

> "*The existence of a corpus, principal, or fund is an essential element of the trust and the preservation of this principal until the termination of the life estates is indispensable to the fullfilment of the testator's plans.* Therefore, *any depletion* of the principal tends to frustrate the fundamental purpose of the trust and should be avoided and where the price paid for a bond consists of more than the par value thereof, that method of accounting should be adopted which will prevent the impairment of

> the principal unless the testator has clearly directed to the contrary. Otherwise the life tenant, who is entitled to receive only income, will, in effect, have received a part of the principal. In other words where a premium is paid, the ostensible interest yielded by the bond cannot be considered entirely as interest on the face value of the bond, for a sum in excess of the face value has gone into the investment and the amount of interest remains unchanged, resulting, necessarily, in a decreased rate of return. A portion of the nominal interest is, therefore, a repayment of the premium.

This is also the view taken by respectable authorities elsewhere.

See, for example, the following authorities which involve depreciation of real estate: *Matter of Jones,* 103 N. Y. 621; *Matter of Housman,* 4 Dem. (N. Y.) 404: *In re Crabtree,* 106 Law Times Reports (N. S.) 49, (decided by Court of Appeal, consisting of Cozens-Hardy, M. R., Fletcher Moulton, L. J., and Buckley, L. J.); Hill on Trustees (Am. ed.) pp. 592-593.

The principle as to the necessity of setting up a reserve to protect the interests of remaindermen has been applied in many cases to various other situations as, for example, to leaseholds: *Healey* v. *Toppan,* 45 N.H. 243, 266-267; *In re Hall's Estate,* 224 N.Y.S. 376, 381; *Gay* v. *Focke,* 291 Fed. 721; Perry on Trusts and Trustees, 7th Ed., Vol. II, par. 548. And in cases of bonds purchased at a premium

in such cases as: *New England Trust Company* v. *Eaton,* 140 Mass. 532; *In re Allis' Estate,* 123 Wis. 223; *Furniss* v. *Cruikshank,* 230 N.Y. 495; *Curtis* v. *Osborn,* 79 Conn. 555; *Ballantine* v. *Young,* 74 N.J. Eq. 572. Contrary to these cases are some cases in other jurisdictions.

There are, of course, many cases holding that a bequest or devise of a wasting asset, without provision for a reserve for depreciation, ordinarily requires no such reserve. This is not such a case. Here we have a general residuary devise. The assets originally covered by it "consisted largely of cash, bonds, stocks and notes" (R. 35). Such assets were not depreciable or wasting in their nature. In subsequent years the nature of the corpus of the trust property has changed. During the year here involved, it consisted almost entirely of improved real estate and hotel furniture. The improvements and furniture are highly depreciable. Under such circumstances, when a trustee acquires wasting assets, the life tenant should not be entitled to the whole rental or other income, but an adequate reserve must be set up in order to take care of the depreciation and protect the interests of the remaindermen.

The phraseology of the will in the case at bar should be given particular attention. The testator was dealing with an estate which consisted largely of nondepreciable assets. Naturally he made no specific provision for depreciation. Nevertheless, his gift to the life beneficiaries is only "the interest

or income," the remaindermen taking "the whole three thirds parts." This, we submit, must be construed as requiring a reserve to take care of the depreciation on depreciable assets in which the trustee subsequently invested the trust funds.

CONCLUSION

The applicable statutes must be construed to tax to the beneficiary only income which was properly distributable to her. This raises the question—what was the income of the trust estate which was properly distributable? That question has been determined by the court of competent jurisdiction, and no decision of any other court can give this petitioner any right to the amount on which the Commissioner seeks to impose a tax. Moreover, the decision of the California state court was correct. The Commissioner is consequently seeking to tax him on a fund to which he was not entitled and never can become entitled. This, we submit, he cannot do. The judgment of the Circuit Court of Appeals should be reversed, and the decision of the Board of Tax Appeals should be affirmed.

Respectfully submitted,

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NOVEMBER, 1933.

APPENDIX.

FEDERAL STATUTES.

Revised Statutes, Section 905 (U.S.C. Title 28, Sec. 687):

The acts of the legislature of any State or Territory, or of any country subject to the jurisdiction of the United States, shall be authenticated by having the seals of such State, Territory, or country affixed thereto. The records and judicial proceedings of the courts of any State or Territory, or of any such country, shall be proved or admitted in any other court within the United States, by the attestation of the clerk, and the seal of the court annexed, if there be a seal, together with a certificate of the judge, chief justice, or presiding magistrate, that the said attestation is in due form. *And the said records and judicial proceedings, so authenticated, shall have such faith and credit given to them in every court within the United States as they have by law or usage in the courts of the State from which they are taken.*

Revenue Act of 1921 (c. 136, 42 Stat. 227, 247):

ESTATES AND TRUSTS

Sec. 219. (a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income received by estates of deceased per-

sons during the period of administration or settlement of the estate;

(2) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interest;

(3) Income held for future distribution under the terms of the will or trust; and

(4) *Income which is to be distributed to the beneficiaries periodically,* whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

(b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of section 214) there shall also be allowed as a deduction, without limitation, any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in paragraph (11) of subdivision (a) of section 214. In cases in which there is any income of the class described in paragraph (4) of subdivision (a) of this section *the fiduciary shall include in the return a statement of the income of the estate or trust which, pursuant to the instrument or order govern-*

ing the distribution, is distributable to each beneficiary, whether or not distributed before the close of the taxable year for which the return is made.

(c) In cases under paragraphs (1), (2), or (3) of subdivision (a) or in any other case within subdivision (a) of this section, except paragraph (4) thereof the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement *there may be deducted the amount of any income properly paid or credited to any legatee, heir, or other beneficiary.* In such cases the estate or trust shall, for the purpose of the normal tax, be allowed the same credits as are allowed to single persons under section 216.

(d) In cases under paragraph (4) of subdivision (a), and in the case of any income of an estate during the period of administration or settlement permitted by subdivision (c) to be deducted from the net income upon which tax is to be paid by the fiduciary, the tax shall not be paid by the fiduciary, but *there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not,* or, if his taxable year is different from that of the estate or trust, then

there shall be included in computing his net income his distributive share of the income of the estate or trust for its taxable year ending within the taxable year of the beneficiary. In such cases the beneficiary shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under Section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the estate or trust.

(e) In the case of an estate or trust the income of which consists both of income of the class described in paragraph (4) of subdivision (a) of this section and other income, the net income of the estate or trust shall be computed and a return thereof made by the fiduciary in accordance with subdivision (b) and the tax shall be imposed, and shall be paid by the fiduciary in accordance with subdivision (c), except that *there shall be allowed as an additional deduction in computing the net income of the estate or trust that part of its income of the class described in paragraph (4) of subdivision (a) which, pursuant to the instrument or order governing the distribution, is distributable during its taxable year to the beneficiaries. In cases under this subdivision there shall be included, as provided in subdivision (d) of this section, in computing the net income of each beneficiary, that part of the income of the estate or trust which, pursuant to the instrument or order governing the*

distribution, is distributable during the taxable year to such beneficiary.

[Subdivision (f) of this section has no possible bearing upon the issues in this case.]

Revenue Act of 1918 (c. 18; 40 Stat. 1057, 1071):

ESTATES AND TRUSTS

Sec. 219. (a) [Identical with the corresponding subdivision of the Act of 1921.]

(b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that there shall also be allowed as a deduction (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of section 214) any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid to or permanently set aside for the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, or any corporation organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual; and in cases under paragraph (4) of subdivision (a) of this section the *fiduciary shall include in the return a statement of each bene-*

ficiary's distributive share of such net income, whether or not distributed before the close of the taxable year for which the return is made.

(c) [Substantially the same as the corresponding subdivision of the Act of 1921.]

(d) In cases under paragraph (4) of subdivision (a), and in the case of any income of an estate during the period of administration or settlement permitted by subdivision (c) to be deducted from the net income upon which tax is to be paid by the fiduciary, the tax shall not be paid by the fiduciary, but *there shall be included in computing the net income of each beneficiary his distributive share, whether distributed or not, of the net income of the estate or trust for the taxable year,* or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the estate or trust is computed, then his distributive share of the net income of the estate or trust for any accounting period of such estate or trust ending within the fiscal or calendar year upon the basis of which such beneficiary's net income is computed. In such cases the beneficiary shall, for the purpose of the normal tax, be allowed as credits in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the estate or trust.

[There was no subdivision in the Act of 1918

corresponding to section 219 (e) of the Act of 1921.]

Revenue Act of 1924 (c. 234; 43 Stat. 253, 275) *and of 1926* (c. 27; 44 Stat. 9, 32):[8]

ESTATES AND TRUSTS

Sec. 219 (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate

[8] The portions of the Acts of 1924 and 1926 bearing upon the present case are identical.

or trust shall be computed in the same manner and on the same basis as provided in section 212, except that

(1) There shall be allowed as a deduction (in lieu of the deduction authorized by paragraph (10) of subdivision (a) of section 214) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in paragraph (10) of subdivision (a) of section 214, or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate of trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be

allowed as a deduction under paragraph (3) in the same or any succeeding taxable year;

(3) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

(c) For the purpose of the normal tax the estate or trust shall be allowed the same credit as is allowed to a single person under subdivision (c) of section 216, and, if no part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, then in addition the same credits as are allowed by subdivisions (a) and (b) of section 216.

(d) If any part of the income of an estate or trust is included in computing the net income of any legatee, heir, or beneficiary, such legatee, heir, or beneficiary, shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a)

and (b) of section 216 as are, under this section, required to be included in computing his net income. Any remaining portion of such amounts specified in subdivisions (a) and (b) of section 216 shall, for the purpose of the normal tax, be allowed as credits to the estate or trust.

(e) If the taxable year of a beneficiary is different from that of the estate or trust, the amount which he is required, under paragraph (2) of subdivision (b) of this section, to include in computing his net income, shall be based upon the income of the estate or trust for its taxable year ending within his taxable year.

[Subdivisions (f), (g) and (h) have no possible bearing upon the issues in this case.]

Revenue Act of 1928 (c. 852; 45 Stat. 791):

[The portions of this act relating to income of trusts and estates (sections 161 to 164, inclusive) are substantially the same as those of section 219 of the Acts of 1926 and 1924.]

Revenue Act of 1928 (c. 852, 45 Stat. 791, 799):

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

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(k) Depreciation. A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of property held

by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

REGULATIONS OF THE TREASURY DEPARTMENT.

Regulations 62 (1922 Edition) promulgated under Revenue Act of 1921 as approved by the Secretary of the Treasury February 15, 1922:

Art. 345. ESTATES AND TRUSTS TAXED TO BENEFICIARIES.—In the case of (a) a trust the income of which is distributable periodically, (b) an ordinary guardianship of a minor, and (c) an estate of a decedent before final settlement as to any income properly paid or credited as such to a beneficiary, the income is taxable directly to the beneficiary or beneficiaries. Each such beneficiary must include in his return *his distributive share* of the net income, even though not yet paid him, but if his taxable year is different from that of the estate or trust, then he need only include in computing his net income his distributive share of the income of the estate or trust for its taxable year ending within his taxable year. The regulations governing

partnerships are generally applicable to such an estate or trust. See articles 331-335.

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Art. 347. ESTATES AND TRUSTS WITH INCOME WHICH IS DISTRIBUTED PERIODICALLY, AND OTHER INCOME.—In the case of an estate or trust, the income of which consists both of income to be distributed to beneficiaries periodically and other income, the net income of the estate or trust shall be computed and a return thereof made by the fiduciary in accordance with section 219 (b) and the tax shall be imposed and paid by the fiduciary in accordance with section 219 (c), except that there shall be allowed as an additional deduction in computing the net income of the estate or trust that part of its income of the class described in section 219 (a) (4) which, pursuant to the will or trust deed, is distributable during its taxable year to the beneficiaries. *Each of such beneficiaries shall include, in computing his net income, that part of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable to him during the taxable year.*